

# Goodwill

of Central Arizona

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January 12, 2006

Ms. Stephanie Hillmon  
Assistant General Counsel  
Committee for Purchase From People  
Who Are Blind or Severely Disabled  
1421 Jefferson Davis Highway  
Suite 10800  
Arlington, VA 22202-3259

Dear Ms. Hillmon:

On behalf of Goodwill Industries of Central Arizona, I am writing to submit comments to the Committee for Purchase From People Who Are Blind or Severely Disabled ("the Committee") in response to the December 16, 2005 Advanced Notice of Proposed Rulemaking (ANPR). We appreciate the opportunity to submit comments prior to the initiation of any formal rulemaking by the Committee.

Our comments address the areas highlighted by the Committee on governance standards and executive compensation as it relates to the fair market price of products and services under the Javits-Wagner-O'Day (JWOD) Act.

### **Qualified Agencies Have Good Governance Practices**

Many nonprofit agencies have already taken the initiative in setting standards for their own organizations to increase accountability and strengthen governance. Two years ago, Goodwill Industries International, Inc. developed a set of recommendations based on the Sarbanes-Oxley Act,<sup>1</sup> and to date, more than 121 of our agencies have adopted a voluntary code of ethics and 131 of our agencies have a conflict of interest policy. Charities have a responsibility to ensure the public's trust, and we have taken our own steps internally as an organization to increase accountability, governance, and transparency. We support the adoption of best governance practices by JWOD-producing entities; however, any effort by the Committee in promulgating new standards should not be duplicative of existing authority and law.

The Committee recommends fourteen best practices as benchmarks of good governance for agencies operating under the JWOD program. A number of the best practices pertain to board members, including the composition of the board, prevention of undue board member influence, board size, term limits, diversity, and service by board members without compensation. Board governance, financial controls,

<sup>1</sup> Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

and ethical standards are critical for not only JWOD-producing entities but all nonprofits.

We address areas the Committee seeks further information on as outlined in the notice:

- (1) Are these criteria comprehensive and inclusive enough to effectively evaluate that a nonprofit agency demonstrates good governance practices and should be deemed qualified to participate in the JWOD program?

By law, members of the board already have a duty of care that calls for them to attend meetings, to participate in decisions, and to be reasonably informed on matters of decision making. We do agree that nonprofit agencies should assess periodically the composition of the board, that is, whether there are sufficient members with the necessary skills, knowledge of programs, finances, and other matters; diversity is also an area that we, Goodwill Industries of Central Arizona, take into consideration. Our board members serve without compensation except for the limited circumstances that require reimbursement for travel expenses and lodging for meetings. The Revised Model Nonprofit Corporation Act (RMNCA) adopts standards for the duties of care and loyalty similar to those found in the business corporation laws in the states; the RMNCA or a statute based on similar concepts has been adopted in at least twenty-three states. The National Association of Attorneys General and the National Association of State Charity Officials have begun improved efforts to coordinate their activities and to work more closely with the Internal Revenue Service (IRS). These are positive steps for more coordinated oversight of the tax-exempt sector.

The board is responsible for setting the compensation of the executive director and board members should be committed to the organization's mission. Our agency has a well-defined mission and the Board oversees implementation of the strategic goals. Reasonable term limits seem favorable in most cases, as it is important that the Board have new ideas and remain impartial; however, some agencies may have sound reasons to extend Board terms to members.

The standards in which to qualify in a JWOD program are already in place through applicable state and federal law on nonprofits; additional governmental regulation and laws are not needed and would be duplicative of existing statutes.

- (2) Are there additional criteria that should be used, or substituted for the above, to evaluate evidence of good governance practices by nonprofit agencies in the Program?

If the Committee were to consider additional criteria to evaluate good governance practices by nonprofit agencies, we would suggest considering accreditation by outside entities, such as the Commission on Accreditation of Rehabilitation Facilities (CARF). Outside accreditation ought to be recognized as evidence of good governance practices; the Committee need not expend additional resources to review matters that have been thoroughly examined by accreditation bodies.

Enforcement mechanisms are in place through the IRS and state attorneys general offices; both need additional resources and increased communication between the two to help enforcement efforts. The best step to avoid conflict of interest is a sound policy in place and a self-enforcement mechanism. The IRS and state attorneys general should be provided with the adequate financial resources in order to enforce the laws already in place.



- (3) Should accreditation by one or more state or national organizations be recognized as evidence of a nonprofit agency adhering to good governance practices without further review by the Committee?

Member Goodwill agencies are accredited either through the Goodwill Industries International, Inc./Member Service Center, CARF, or the state. We do believe that this ought to be recognized by the Committee as evidence of an agency adhering to good governance practices. If the agency is accredited by a recognized body, then the Committee need not review further any more evidence of good governance practices of that agency. An outside, third-party entity offers an impartial review of an agency's practices.

- (4) Should different benchmarks be used for nonprofit agencies that are state, county, or local government agencies, or should they be exempt from any Committee regulations in this area?

State, county, or local government agencies could adopt the recommendations set forth in the notice in some instances; however, these entities may have additional requirements given their status as governmental bodies.

- (5) Should the size and/or the annual revenue of the nonprofit agency be a factor or factors in assessing appropriate governance practices?

In terms of assessing the size and/or annual revenue of the nonprofit agency as a factor in assessing appropriate governance practices, there is concern that smaller agencies may not have the resources for an annual outside, independent audit, for instance, and may have difficulty in rotating auditors, if the agency, for example, is located in a small town with few accounting firms. These are a few examples of how size and revenue should be considered when assessing appropriate governance practices.

In certain circumstances, we recognize that smaller nonprofit agencies, such as those with revenues of less than \$1 million per year, may have difficulty in meeting audit and other requirements. In some instances, rural agencies may have difficulty with rotating auditing firms, given a lack of accounting firms in various communities. An agency's size should be given consideration in any discussion on governance practices to determine what is practical and reasonable. Since most of our agencies do not rely solely on JWOD contracts for their revenue, we are referring to total agency revenues.

- (6) What is the best way to ensure that only qualified central nonprofit agencies and nonprofit agencies, with an internal structure that minimizes opportunities for impropriety, participate in the JWOD program?

Last year, Goodwill Industries International, Inc. recommended guidelines to its members based on the Sarbanes-Oxley Act. These guidelines included outside, independent audits, internal controls, signed 990 Forms by the Chief Executive Officer and Chief Financial Officer. All of these recommendations represent sound financial responsibility on the part of nonprofit agencies.

Goodwill Industries recognizes that financial reporting and an integrated system of internal controls are key responsibilities of our Chief Executive Officers and Chief Financial Officers. We believe that periodic review of our financial status by our Board of Directors is an essential and integral part of their duties. We further recognize that an annual independent examination and assessment of our finances under the supervision of an Audit Committee is a key element in maintaining our credibility and ensuring the safeguarding of our assets.

Although the guidelines are voluntary for our members to adopt, many have already adopted the guidelines and demonstrated a renewed commitment to increased fiscal responsibility.



These recommendations go a long way in ensuring that the internal structure of an organization minimizes opportunities for impropriety, particularly for those entities participating in the JWOD program. Although many of the provisions in the Sarbanes-Oxley Act are not applicable to nonprofits, Goodwill Industries believes that the proactive establishment of effective fiscal management and a voluntary compliance program makes good business sense. Many of our members have adopted the following best practices:

**Financial Statements** issued at least quarterly that report to our Audit Committee and Board of Directors the financial position and results of our operations of the organization in accordance with generally accepted accounting principles.

**Internal Controls** for each member Goodwill agency that will create an integrated system that encompasses the effectiveness and efficiency of operations and the safeguarding of assets. An annual assessment of the internal control system will be provided to our Audit Committee and Board of Directors.

**Annual Audit** for each Goodwill agency and to engage an independent accounting firm to conduct an examination of our financial statements.

**Audit Committee** for each Goodwill agency of at least three volunteers, one of whom qualifies as a financial expert. We have also recommended that our Goodwill agencies issue a Request for Proposal minimally every five years to select the independent accounting firm. If the same firm is selected for more than a five-year period, the engagement partner of the independent accounting firm should be changed.

**Whistle Blower Protection** policy for each Goodwill agency that includes procedures outlined for employee complaints of improper financial activity and a mechanism with which to resolve complaints.

**Conflict of Interest** policy for each Goodwill agency that governs our officers, employees, and volunteers. Goodwill agencies that have not already done so are including this policy within their employee handbooks.

**Document Destruction** policy that includes financial records to be archived for a specific period of time, as well as electronic mail and voice mail. In addition, we have a suggested record for retention of documents.

As part of its accreditation process, some Goodwill agencies participate in a corporate compliance program known as the Commission on Accreditation of Rehabilitation Facilities (CARF). CARF released a Standards Manual that has become the basis for the accreditation of many of our local Goodwill agencies. Organizations that receive federal funds (either directly or indirectly) must conform to the corporate compliance standards that have been recently implemented through the CARF accreditation process. We have 131 Goodwill agencies that are CARF accredited.

#### **Effect of Executive Compensation on Fair Market Price Determinations**

The Committee notes that Board involvement in setting the compensation of the CEO/President and other highly compensated employees is one of the benchmarks of effective nonprofit governance practices. We agree. However, in relation to using this to set fair market price for products and services, we must note that other factors influence the price of products and services rather than solely the compensation paid to the executives in a JWOD participating agency. To that end, we cannot see the nexus between an established benchmark or absolute dollar threshold above which compensation would be deemed as influencing a proposed fair market price.



As per the Committee's request, we have addressed the following questions.

- (1) What is the threshold beyond which the compensation paid to the executives in a JWOD participating nonprofit agency should be considered as influencing a proposed fair market price determination? For example, if the agency receives more than a certain percentage of its total revenue from sales through the JWOD Program, is there a compensation level (total dollars paid or total dollars paid as a percentage of total revenue) at and above which fair market price impact would be deemed to occur?

First, the Committee would need to understand how a participating agency allocates the executive's compensation, as a result of the executive's contribution to the management and performance of mission and revenue-generating activities of the organization. With an agency with a small percentage of JWOD contracts, an executive may only spend a small percentage of their time on JWOD management duties or the converse. Once this is known, an opinion can be formed about whether or not the allocated executive compensation as a percentage of JWOD revenues might adversely impact the fair market price; we doubt such would occur. Since the Committee's standard procedure is to review and analyze a proposed price in the context of a competitive range of prices offered by bidders during the previous solicitation period or other market pricing method, discussion of any impact that executive compensation might have on the fair market price is null.

- (2) Conversely, is there a point below which executive compensation, regardless of the dollar amount paid, would not be considered as influencing a recommended fair market price? Is such a *de minimis* test appropriate for large diversified nonprofits where total JWOD sales represent only a small percentage of total revenue?

Many factors influence a recommended fair market price more so than an executive's compensation. A *de minimus* test would not be appropriate for organizations whose sales revenue represents a small percentage of total revenue.

- (3) Without regard to any analysis of JWOD-related revenue, is there an established benchmark or absolute dollar threshold above which compensation would be deemed as influencing a proposed fair market price?

Executive compensation is determined by an organization's board of directors according to policies and procedures established by the board. As such, executive compensation is a legitimate component of the organization's overhead cost structure.

When organizations negotiate prices for contracts they are not always able to recover all of their overhead costs through the price a customer is willing to pay. But as long as the price is greater than the variable costs of production, there will be a contribution to overhead and management may choose to or may not go forward with the contract.

This fact demonstrates that prices are best set through a negotiation process between buyer and seller, leaving the details of how an organization covers its overhead costs (including executive compensation) to the organization's management.

- (4) Should receipt of documentation to support a "rebuttable presumption of reasonableness" serve to demonstrate that executive compensation does not by itself influence a proposed fair market price or any adjustment thereto?

Goodwill Industries of Central Arizona, Inc. recommends that nonprofit organizations follow the guidelines from the Internal Revenue Service<sup>2</sup> in establishing a rebuttal presumption of reasonableness in relation to executive compensation. The three conditions to meet the presumptions are as follows: (1) the compensation was approved by a disinterested board or committee of the corporation or trust, (2) that obtained and relied upon appropriate data as to comparability, and (3) that adequately documented the basis for the comparison.

Many nonprofits, including Goodwill Industries of Central Arizona have set compensation policies to follow these procedures. To require that individual agencies report this information to the Committee adds yet another reporting requirement that seems duplicative and unnecessary. There is federal oversight through the IRS in this area.

- (5) To what extent should there be a relationship between the pay and compensation of line workers and highly compensated individuals?

Agencies involved with the JWOD program must follow the applicable local, state, and federal laws regarding compensation of workers in the program. These laws include the Fair Labor Standards Act.

- (6) At what point would be appropriate to begin a review of an executive compensation package even if the proposed price for a product or service would fall within a range that it could be considered as a fair market price?

The agency's board of directors and the compensation committee should determine the appropriate time to review an executive's compensation package.

- (7) What approaches are available to identify and monitor nonprofit agencies executive compensation that would provide such information to the Committee routinely but without placing an undue burden on agencies?

The Committee has the ability to obtain this information through the Form 990 filings, which is public information.

Thank you again for the opportunity to provide input to the Committee on governance and compensation issues. We look forward to continuing the dialogue.

Sincerely,



Keith Mason  
President & CEO  
Goodwill Industries of Central Arizona

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<sup>2</sup> I.R.C. § 4958

